

Scholarships and Fellowships - Tax Treatment Issues

Scholarships/Fellowships (See IRS Publ. 970 - Tax Benefits for Education):

A scholarship is generally an amount paid or allowed to, or for the benefit of, a student at an educational institution to aid in the pursuit of studies. The student may be either an undergraduate or a graduate.

A fellowship is generally an amount paid for the benefit of an individual to aid in the pursuit of study or research.

Qualified Scholarship or Fellowship:

A scholarship or fellowship is tax free only if:

- You are a candidate for a degree at an eligible education institution, and
- You use the scholarship to pay qualified education expenses.

Qualified Education Expenses for purposes of tax-free scholarships and fellowships are expenses for tuition and fees required to enroll at or attend an eligible education institution and course-related expenses, such as fees, books, supplies and equipment that are required for the course at the eligible educational institution. These items must be required of all students in your course of instruction.

Qualified scholarships or fellowships are usually applied directly to the student's account and the income is not subject to tax withholding and it is not reportable income.

Nonqualified Scholarship or Fellowship:

If a scholarship or fellowship is used for expenses that do not qualify for tax-free purposes, then the individual has received a nonqualified scholarship or fellowship, which is taxable. A nonqualified scholarship is income the student receives that is above the cost of required tuition, fees, books, supplies and equipment. This income is normally used for the following nonqualified education expenses:

- Room and board
- Travel
- Research
- Clerical help
- Equipment or other expenses not required for enrollment in or attendance at an eligible educational institution.

For U.S. citizens and Resident Aliens for tax purposes, this income is self-reported. The student will not receive a Form 1099 or W-2 (unless deemed pay for services, i.e., earned income), and tax is not withheld on the income up front. It is advised that the students contact their personal tax advisor regarding the self-reporting and tax consequences.

Nonresident Aliens, however, are subject to tax withholding and reporting on nonqualified scholarships or fellowships.